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Hon. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW (7th fl.)
Washington, DC 20423-0001

Dear Secretary Williams:

Enclosed for filing in STB Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures, are the original and twenty-five copies of the Rebuttal Comments of Enterprise Products Operating L.P. (EPO-2).

Also enclosed is a dikette with the text of the filing in WordPerfect format.

Additional copies off this letter and of the Rebuttal Comments are enclosed for you to stamp to acknowledge your receipt of them and to return to me via the messenger.

If you have any question concerning this filing which you believe I may be able to answer or if I otherwise can be of assistance, please let me know.

Sincerely yours,

Fritz R. Kahn

enc.
cc: John E. Smith II, Esq.

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ORIGINAL

EPO-2

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, DC

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS
OF
ENTERPRISE PRODUCTS OPERATING L.P.

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Due and dated: January 11, 2001

EPO-2

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS
OF
ENTERPRISE PRODUCTS OPERATING L.P.

Enterprise Products Operating L.P. ("EPO"), pursuant to the Notice of Proposed Rulemaking, served October 3, 2000, rebuts the railroads' Reply Comments, filed December 18, 2000, as follows:

A.

Introduction

The Association of American Railroads ("AAR") and its Class I railroad members in their Reply Comments failed to respond to EPO's Comments. AAR, The Kansas City Southern Railway Company ("KCS"), Union Pacific Railroad Company ("UP"), Canadian National Railway Company ("CN") and Canadian Pacific Railway Company ("CP") did not even mention EPO's Comments, and, while The Burlington Northern and Santa Fe Railway Company ("BNSF"), CSX Transportation, Inc. ("CSXT"), and Norfolk Southern Railway Company ("NS") at least referred to EPO's Comments, none of the railroads addressed the merits of EPO's views or the efficacy of the conditions it recommended be attached to the Board's approval of future major railroad mergers or acquisitions.

The railroads in their Reply Comments, accordingly, neglected to note that one of the asserted failings of the Board's proposed regulations, namely their lack of specificity, creating "great uncertainly because it is unclear what would suffice to pass Board muster,"[1] had been found objectionable as well by EPO. EPO, however, did not merely criticize the Board for failing to craft rules of sufficient precision; in its Comments, EPO proposed regulations that are clear, certain and concise, as we shall discuss hereinafter.

The railroads in their Reply Comments, moreover, contended that any conditions imposed by the Board when approving a future major railroad merger or acquisition must relate to the evidence of record in the proceeding, and conditions, if any, should be imposed only on a case-by-case basis.[2] The need for tailoring conditions to the evidence of record in a particular proceeding had been anticipated by EPO and was satisfied by the conditions it recommended for adoption. EPO's proposed conditions are designed to be fact specific, as we shall discuss hereinafter.

B.

The railroads disagree with <u>the basic premise of the NPR.</u>

Of all of the railroads, only UP appears to have grasped the concerns that prompted the Board to undertake the revision of the

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[1] AAR, p. 7. <u>See</u>, <u>also</u>, BNSF, pp. 15, 19; CSXT, p. 28; KCS, pp. 5, 11.

[2] <u>See</u>, <u>i.e.</u>, AAR, pp. 2, 4; BNSF, pp. 7, 10; NS, pp. 7, 18.

regulations governing major railroad mergers or acquisitions. At page 8 of its Reply Comments, UP acknowledged:

> The important public policy questions in the next major Class I merger proceeding will focus on whether a North American Railroad duopoly is in the public interest. The Board will chose between a future in which two huge transcontinental systems develop single line services in isolation from each other and a future in which all remaining railroads strive to develop more efficient service over remaining interline routes. This is an important choice that can be made only once, because mergers are likely to be permanent.

Nevertheless, UP joined AAR and its Class I railroad members in trashing the Board's basic beliefs that 1) whether the applicants' merger proposal will enhance rail-to-rail (intramodal) competition needs to be a factor taken into consideration by the Board in determining a major railroad merger or acquisition's consistency with the public interest and 2) that the Board's conditioning power is broad enough to permit it to impose requirements for enhancing competition if necessary to render the proposed transaction approvable by the Board.[3]

The railroads maintain that the Board's espousal of enhanced rail-to-rail or intramodal competition is unprecedented, and unquestionably, it is. The Board itself acknowledged in its NPR, "Our proposed revisions . . . represent a paradigm shift in our review of major mergers." The situation in which the Board finds itself, however, is no less unprecedented. The merger regulations are not being revised as if the year were 1980 and there continued to be no fewer than 23 Class I railroads, as the

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[3] See, i.e., AAR, p. 4, BNSF, pp. 17, 24; CN, p. 5; CP, p. 8; CSXT, pp. 11, 14; KCS, p. 5; NS, pp. 7, 21; UP, p. 12.

railroads' Reply Comments seem to suggest. The proposed revision of the Board's merger regulations comes at a time when there are only two major U.S. railroads in the East and two in the West and, as the UP correctly noted, the next round of mergers is likely to result in two huge transcontinental railroad systems. The Board would have been derelict in the duty it owes the public if, given this situation, it had not reexamined its statutory authority and seen the need for modifying its major railroad merger rules. That the result of the Board's NPR may be the promulgation of merger rules that are without precedent is of no moment, just as long as the Board explains the reasons for the regulatory changes it is adopting. As the Supreme Court said in American Trucking v. A., T. & S. F. R. Co., 387 U.S. 397, 416 (1967):

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.

As opposed as they are to the very ideas that rail-to-rail or intramodal competitive enhancement is a factor which the Board may consider in determining whether a proposed railroad merger or acquisition is consistent with the public interest and that conditions designed to enhance competition should be imposed, AAR and its Class I member railroads in their Reply Comments are careful not to contend that such actions by the Board would exceed its statutory authority, under 49 U.S.C. 11323, et seq.

The railroads term the proposed rule changes the "wrong approach"[4] and contrary to "sound regulatory policy;"[5] the railroads, however, do not maintain that the Board's regulatory revisions are *ultra vires*. The railroads' silence is eloquent testimony to the broad powers with which the Board has been entrusted in passing on proposed railroad mergers and acquisitions.

The AAR and its Class I member railroads, however, do maintain that the imposition by the Board of what they term "mandatory, non-remedial conditions" would be tantamount to "reregulation" of the industry.[6] Indeed the specter of industry reregulation is portrayed throughout the railroads' Reply Comments as the dreaded consequence of the Board's NPR. Although EPO disputes that the conditions it has proposed would reregulate the industry, the railroads seem to forget that, although they have been substantially deregulated, they remain and benefit from being a regulated industry. Indeed, the next round of major railroad mergers or acquisitions would be impossible but for the authority of the Board to approve the proposed transactions as consistent with the public interest notwithstanding their obvious violation of the antitrust laws. The railroads note that future mergers or acquisitions likely to be undertaken by the major railroads will be end-to-end combinations heretofore found by the

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[4] UP, p. 12.

[5] BNSF, p. 21.

[6] See, i.e., AAR, pp. 2, 4; BNSF, pp. 9, 21: CSXT, 7, 31; NS, pp. 17, 21.

Board "not [to] result in competitive harm,"[7] or to "be harmful to the public interest."[8] The railroads conveniently overlook the fact that, notwithstanding the Board's prior decisions to the contrary, vertical mergers or affiliations may be as anticompetitive as horizontal ones.[9] Moreover, but for the shelter from the antitrust laws the Board's regulation affords, the next major Class I merger proceeding would not survive the application of the Herfindahl-Hirschman Index by which proposed mergers in unregulated industries are tested under section 7 of the Clayton Act.[10]

Reregulation of the industry, the railroads maintain, would mean the end of their ability to differentially price their services, which, they contend, is essential if they are to survive financially.[11] Again, the railroads conveniently overlook the undeniable point that differential pricing has always been part of their rate structure; in the past it simply was called making rates according to what the traffic will bear.[12] The railroads differentially priced their services when

[7] CSXT, p. 34.

[8] CP, p. 3.

[9] See, Ford Motor Co. v. United States, 405 U.S. 562, 570 (1972); Brown Shoe Company v. United States, 370 U.S. 294, 323-24 (1962).

[10] 15 U.S.C. 18.

[11] See, i.e., BNSF, p. 15; NS, p. 19-20.

[12] See, Wyman, Railroad Rate Regulation (2d ed.), §432, p. 370 (1915); Goodman, The Process of Ratemaking, part 15, p. 885, et seq. (1998).

pervasively regulated; they assuredly can do so when they are minimally regulated, as they would be even if EPO's recommended rules revisions were adopted by the Board.

In sum, the railroads' Reply Comments assault upon the Board's effort to attach a far more significant role to the enhancement of rail-to-rail or intramodal competition falls short of its mark. Indeed, as EPO asserted in its Comments — as did most commenting shippers — the Board did not go nearly far enough.

C.

There is a need for
a gateway condition.

Although NS in its Reply Comments conceded the need for maintaining "major efficient gateways," as some of the other railroads did as well,[13] NS was opposed to the imposition of DT&I or similar conditions, contending that "the *DT&I* conditions . . . nearly bankrupted the railroad industry."[14] As much as has been written about the demise of the Penn Central Transportation Company, The Milwaukee Road and The Rock Island, none of the observers attributed the railroads' failures to the DT&I conditions.[15] It well may be that NS does not understand how the

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[13] See, BNSF, p. 25; CSXT, p. 38.

[14] NS, p. 25.

[15] The Penn Central and Other Railroads, a Report to the Senate Committee on Commerce, 92d Cong., 2d Sess. (1972); Saunders, The Railroad Mergers and the Coming of Conrail (1978); Wilner, Railroad Mergers — History Analysis Insight (1997).

DT&I conditions work; UP, however, had it right when, at page 14 of its Reply Comments, it said:

> Keeping a gateway open merely preserves the status quo. For example, in a hypothetical NS-BNSF merger, the condition would require NS to continue to exchange traffic at St. Louis with UP and Gateway Western, as well as with its merger partner BNSF. BNSF would maintain service with CSX as well as NS. UP, Gateway Western, and CSX wold continue to exchange traffic with the merged carriers, NS and BNSF. The merged entity would suffer no disadvantage from continuing to do what it does today.

Of course, if it makes sense to keep major gateways open, as some of the railroads concede, it would seem to make no less sense that all gateways be kept open by the merged or controlled or controlling railroads. The railroads thereby in no way would be impeded it operating through trains or otherwise passing along to their shippers the service advantages of single-line service, as some of them have contended.[16] EPO, accordingly, renews its request that the Board adopt a rule that would in effect provide:

> Any merger or acquisition shall be conditioned to require the merged or controlled and controlling railroads to maintain and keep open all routes and channels of trade via existing junctions and gateways unless the applicants were able to prove by substantial evidence that the imposition of such a condition would be contrary to the public interest.

Such a rule would be specific and would enable the railroads to limit its application in accordance with the facts adduced in a particular proceeding.

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[16] See, i.e., BNSF, p. 26.

D.

There is a need for a bottleneck condition.

Akin to keeping gateways open is having the merged or controlled and controlling railroad offer rates between a point served only by it and a junction with another railroad, a so-called "bottleneck segment." Some of the railroads concede the need for a bottleneck condition, limited "to situations where there are existing contracts."[17] EPO in its Comments called attention to the fact that, since the bottleneck railroad can retaliate against the competing railroad in a situation where their roles are reversed, securing a contract for the competitive portion of a through route is very difficult, if not impossible. Certainly, the Board is without power to compel a non-merging carrier to enter into a contract with a shipper, as BNSF correctly noted.[18] Thus, the Board should adopt a rule that in effect would provide:

> Any merger or acquisition shall be conditioned to require the merged or controlled and controlling railroads to offer, upon request of a shipper, a local or proportional rate applicable between a point it alone can serve and a point of connection with another railroad, regardless whether the shipper has a contract for service by the connecting railroad, unless the applicants were able to prove by substantial evidence that the imposition of such a condition would be contrary to the public interest.

Such a rules would be clear and, at the option of the applicants, would be fact specific.

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[17] CSXT, p. 38.

[18] BNSF, p. 29.

E.

There is a need for conditions compensating for the impairment of rail-to-rail competition.

KCS in its Reply Comments is the most outspoken of all the railroads in acknowledging the need for safeguarding shippers from any loss of actual or potential rail-to-rail or intramodal competition as a result of a major railroad merger or acquisition:

> Merger applicants should be charged with the responsibility of providing viable alternative rail service for any shippers losing such service in a merger. In this matter, the Board should do more than merely preserve competition at 2-to-1 points, as it has traditionally done. Instead, all competitive options should continue to exist in a post-merger environment.[19]

In its Comments EPO proposed two rules that safeguard against the loss of competition. The first was intended essentially to codify the existing practice with respect to two-to-one shippers. Such a rule would provide in effect:

> Any merger or acquisition shall be conditioned to require the merged or controlled and controlling railroads to provide at reasonable charges, to be agreed to by the parties or set by the Board, trackage or haulage rights to another railroad so as to enable the other railroad to serve a shipper suffering a loss of actual or potential competitive railroad service as a result of the proposed merger or acquisition unless the applicants were able to prove by substantial evidence that the imposition of such a condition would be contrary to the public interest.

The second rule was designed to afford a shipper served only by a a merged or controlled and controlling railroad access to a

[19] KCS, p. 8. See, also, BNSF, pp. 10-11; NS, p. 24; CP, pp. 10-11; UP, pp. 18-19.

second carrier within essentially the same switching district or terminal area. Such very limited competitive access, EPO argued, is essential if rail-to-rail or intramodal competition were to be enhanced, as the Board's NPR insisted was one of the goals in revising the major railroad merger rules. EPO's rule in effect would provide:

> Any merger or acquisition shall be condition to require the merged or controlled and controlling railroads to provide reciprocal switching or switching at reasonable fees, to be agreed to by the parties or set by the Board, to any shipper seeking to be served by another carrier within or proximate to the switching district or terminal area on the lines of the merged or controlled and controlling railroads unless the applicants were able to prove by substantial evidence that the imposition of such a condition would be contrary to the public interest.

These rules would be clear and, depending upon what showing the applicants were able to make, would be limited to the facts of the particular case.

F.

There is need for a condition to protect the rate base.

EPO believes — as some public bodies[20] and most other commenting shippers[21] — that the goal of rail-to-rail or intramodal competitive enhancement would be well served if the rate base of the merged or controlled and controlling railroad were not inflated by an excessive price paid to effect the proposed transaction or any extraordinary costs incurred in

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[20] See, i.e., USDA, pp. 16-17; PSC of ND, p. 5.

[21] See, i.e., NITL, pp. 26-27; CMA/APC, pp. 9-10; EEI, p. 11; Dow, pp. 17-19; PPL, pp. 12-15; Coal Shippers, p. 23-25.

consummating it. EPO is well aware that the Board in prior decisions rejected the exclusion from the carrier's rate base of the acquisition premium paid to effect the merger[22] or the unusual costs incurred in coping with the service failures resulting from its consummation.[23] As already noted, however, in promulgating revised major railroad merger rules the Board is not hobbled by its precedents, particularly when a fair reading of the generally accepted accounting standards would permit the agency to reach a contrary conclusion. EPO, accordingly, renews its recommendation that a rule be adopted along the lines of the following:

> Any merger or acquisition shall be conditioned so as to disallow any acquisition premium paid to effect the proposed transaction or extraordinary costs incurred in consummating it to be included in the merged or controlled and controlling railroads' rate bases unless the applicants were able to prove by substantial evidence that the imposition of such a condition would be contrary to the public interest.

Such a rule would be precise and, if the applicants were to make the requisite showing, would apply on a case-by-case basis.

G.

Conclusion

The railroads in their Reply Comments failed to address meaningfully the views expressed and the conditions proposed by

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[22] STB Finance Docket No. 33388, CSX Corporation, et al--Control and Operating Leases/Agreements--Conrail Inc., et al., served July 23, 1998, rev. pend., No. 98-4285, Erie-Niagara Rail Steering Comm. v. S.T.B. (2d Cir.).

[23] STB Finance Docket No. 33726, Western Coal Traffic League v. Union Pacific Railroad Company, served May 12 and November 30, 2000.

EPO in its Comments. The railroads, accordingly, failed to recognize that the proposed conditions had the specificity and allowed for their case-by-case application, the lack of which were the principal criticisms which the railroads leveled at the Board's proposed competition-enhancing conditions. EPO's proposed conditions are modest and reasonable, and they warrant adoption by the Board.

Respectfully submitted,

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By its attorneys,

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Due and dated: January 11, 2001

CERTIFICATE OF SERVICE

I certify that I this day have served copies of the foregoing Rebuttal Comments upon counsel for each of the parties by mailing them copies thereof, with first-class postage prepaid.

Dated at Washington, DC, this 11th day of January 2001.

Fritz R. Kahn